

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ARPER DISCOUNT CENTER, LTD. AND KANAT ARBAY, AS OFFICER	:	DETERMINATION
	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 1980 through August 31, 1982.	:	

Petitioners, Arper Discount Center, Ltd. and Kanat Arbay, as officer, 75 Taconic Road, Greenwich, Connecticut 06830, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1980 through August 31, 1982 (File Nos. 801116, 801117, 801607, 801608, 802216 and 802217).

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York on March 6, 1990, at 9:45 A.M. Petitioners appeared by Jack M. Portney, C.P.A. The Division of Taxation appeared by William F. Collins, Esq. (Irwin Levy, Esq., of counsel).

ISSUES

- I. Whether the Division of Taxation properly determined additional sales and use taxes due on the gasoline service station operations of petitioner Arper Discount Center, Ltd.
- II. Whether petitioner Kanat Arbay was a person required to collect tax on behalf of the corporate petitioner and is thus liable for unpaid sales and use taxes due.
- III. Whether the Division of Taxation properly imposed the 50% fraud penalty.

FINDINGS OF FACT

Petitioner Arper Discount Center, Ltd. operated a Power Test gasoline station located at 2243 Route 112, Medford, New York, from early 1980 to March 31, 1982. The station had 12 gas nozzles and it was determined that no repair work was performed at this station. Petitioner

Kanat Arbay was president and owner of Arper Discount Center, Ltd.

Initially this case was assigned to Richard Hinrichs, a former tax auditor with the Suffolk District Office of the New York State Department of Taxation and Finance. A letter dated October 19, 1981 scheduled an appointment with Arper Discount Center, Ltd. for October 26, 1981 for a sales tax field examination for the period December 1, 1978 through August 31, 1981. This appointment letter stated in pertinent part:

"All books and records pertaining to your Sales Tax liability for the period under audit should be available. This would include journals, ledgers, Sales invoices, purchase invoices, cash register tapes, exemption certificates and all Sales Tax records. Additional information may be required during the course of the audit...."

Information obtained pursuant to meetings that apparently took place as a result of the field examination revealed that Arper Discount Center, Ltd. had registered with the Division of Taxation on September 1, 1980. There was evidence that this gas station was in operation as early as January 1980. The audit period was therefore revised to reflect some of this information and the examination was performed for the period April 1, 1980 through August 31, 1981.

On April 1, 1985, Theresa Albrecht, Tax Auditor I, prepared a summary which was intended to be an audit report, summarizing what apparently took place with respect to the original audit and field examination. This report indicates that transcripts of sales per books were not made since there were no records of sales made available upon audit. However, transcripts were made of purchases per books and purchases per Federal income tax returns filed. These amounts were reconciled and subsequently compared to sales tax returns. The report noted that during the period in audit, the corporation reported approximately \$35,000.00 in taxable sales on its sales tax returns and noted purchases per books and Federal income tax returns of approximately \$988,000.00.

There is no mention in the record as to who made these comparisons nor whether Mr. Arbay or any representative of him or the corporation was contacted. There is nothing in the record to indicate that any other analysis was performed. At some point, a computation was made using purchases per books to compute audited taxable sales. Purchases for the period

June 1, 1980 through February 28, 1981 of \$651,449.12 were marked up an estimated 20% to arrive at audited taxable sales of \$781,738.94, as compared to taxable sales reported of \$24,334.00. The additional taxable sales resulted in additional tax due of \$53,018.34, and Assessment Notice Numbers S831220051F and S831220050F were issued against Arper Discount Center, Ltd. and Kanat Arbay, as officer, respectively, on December 20, 1983. Included on the notices was a 50 percent fraud penalty and interest, for a total assessment of \$100,145.64 against each petitioner for the period June 1, 1980 through February 28, 1981.

The Notice of Determination and Demand for Sales and Use Taxes Due indicated that the taxes were due in accordance with Section 1138 of the Tax Law and were based on an audit of the taxpayer's records. It indicated the following:

<u>"Period</u>	<u>Tax Due</u>	<u>Penalty Due</u>	<u>Interest Due</u>
083180 - 181	\$10,729.12	\$ 5,364.56	\$ 4,620.36
113080 - 281	12,922.04	6,461.02	5,163.73
022881 - 381	29,367.18	14,683.59	10,834.04

THE TAX ASSESSED HEREIN HAS BEEN ESTIMATED OR DETERMINED TO BE DUE IN ACCORDANCE WITH THE PROVISIONS OF SECTION 1138 OF THE TAX LAW AND MAY BE CHALLENGED THROUGH THE APPEALS PROCESS BY FILING A PETITION WITHIN 90 DAYS.

In addition to tax, a fraud penalty of 50% of the tax due plus statutory interest have been assessed pursuant to Section 1145(a)(2) of the Tax Law."

Although the notices described above were submitted into evidence for purposes of clarity of the record, it was determined by the parties that a petition was not filed on behalf of Arper Discount Center, Ltd. or Kanat Arbay, as officer, for either Notice Number S831220051F or S831220050F for the tax, penalty and interest as described above.

Executed with respect to the taxable periods March 1, 1980 through November 30, 1981, was a consent extending the period of limitation for assessment of sales and use taxes under Articles 28 and 29 of the Tax Law allowing appropriate amounts of sales and use taxes to be determined for those periods at any time on or before December 20, 1983. The vendor is identified as Arper Discount Center, Ltd. and it contains the signature of Jack Portney, C.P.A., petitioners' representative.

Also as a part of the Suffolk audit computations, additional audited taxable sales were computed for the period March 1, 1981 through August 31, 1981. Purchases of \$821,556.86 were marked up 20% to arrive at audited taxable sales of \$985,868.22. Additional tax due of \$66,325.08 was thereby computed, resulting in the issuance on September 20, 1984 of Assessment Notice Number S840920015F to Arper Discount Center, Ltd. and Notice Number S840920016F,¹ against Kanat Arbay, as officer, for tax due of \$66,325.08 plus a 50% fraud penalty and statutory interest resulting in a total assessment of \$129,161.75.

It is important to note that neither the Suffolk District Office auditor, nor anyone involved in the preparation of these computations, nor the preparer of the audit report, Ms. Albrecht, appeared at the hearing to testify. One of the two witnesses presented by the Division to explain what had taken place with respect to petitioners was Grace Reuter, a sales tax auditor with the Nassau District Office.

Ms. Reuter testified that the file held by the Suffolk District Office with respect to these petitioners was transferred to the Special Investigations Bureau with an implication that further investigation was mandatory in this case due to large discrepancies in reported amounts of sales tax as compared to amounts per books and Federal returns. The witness implied that Special Investigations was to continue review of this file and that Suffolk in no way had completed its audit of petitioners' records.

Mr. Andrew Coughlin formerly of the Special Investigations Bureau, testified that the Arper Discount Center, Ltd. case was assigned to him on February 26, 1982, having been sent to him from the Suffolk District Office. A status report from the Suffolk auditor was attached to the file indicating that he had compared purchases per books to bank deposits for a portion of the time that the gas station was owned by Kanat Arbay. Apparently, the differences between sales as reported on the sales tax return and purchases per the Federal income tax return and per books were not discussed with petitioners' representative at that time, Frank Gulotta, since no

¹The record indicates that there is a clerical error with respect to this notice number, and that its correct number may in fact end in a 9 rather than a 6.

power of attorney was on record. Mr. Gulotta had been asked to provide further records to the field auditor and was instructed to contact the auditor when he was in possession of the records.

Mr. Coughlin proceeded by sending out an appointment letter requesting an opportunity to review the corporation's records on March 15, 1982. He visited the premises June 8, 1982, and observed that there were 8 pumps at the station and a new owner had taken occupancy. Mr. Coughlin testified that a new ST-105 certificate of authority had been filed with the Division indicating that as of February 4, 1982, the business was being operated by Kala Discount. Having reviewed the discrepancy between the sales reported per sales tax returns and purchases for the same time period, he testified that it was the procedure of the Division to pursue third-party verification from suppliers of gasoline. Mr. Coughlin subsequently subpoenaed the records of Power Test during January 1983, requesting the lease agreement and a statement of monthly itemized gasoline sold for the period May 1, 1980 through March 31, 1982.

The testimony in this case further disclosed that petitioners did not take issue with the verification of purchases according to the Power Test information supplied to the Special Investigations Bureau, and that in fact, petitioners had reported substantially the same amount of purchases for a similar time period. The primary focus for review was the small amount of sales reported on the sales tax returns.

When Mr. Coughlin pursued an explanation for the discrepancy, he was informed that it was due to gasoline being resold to other parties by petitioners. Both Mr. Gulotta, the former representative of petitioners and Mr. Portney, petitioners' current representative, who appeared at this hearing, provided the Special Investigations Bureau with schedules showing the gasoline purchased as being in agreement with the Power Test information, as well as further information showing the resale of gasoline in gallons and dollars. As the investigation proceeded and Mr. Portney assumed full responsibility for the representation of petitioners, he was requested to provide further information to support the resale claim. The additional information sought by Mr. Coughlin included cash register receipts, daily sheets kept by the gas

station showing the measurement of gasoline in the tank, sales invoices and any resale certificates. During the time that Mr. Portney was attempting to gather this information for Mr. Coughlin, the Special Investigations Bureau was terminated. Petitioners' case herein was transferred to the Nassau District Office² at which point this office was instructed to close out the case. The auditor assigned to the case was James Day, and his supervisor or team leader was Grace Reuter. Ms. Reuter testified that a memo was circulated indicating that the case be closed based on information regarding purchases in the file. No one in the Nassau office contacted petitioners nor obtained any further information with regard to the file. It was obvious that Nassau also was unaware that the Suffolk District Office had already issued an assessment for some of the sales tax quarterly periods.

The field audit report prepared by the Nassau office indicated that the corporation did not maintain any records to substantiate book figures with respect to purchases or sales and as a result, the records were deemed inadequate and incomplete. Thus the audit computations performed utilized gas purchases per the Power Test source verification. Taxable gasoline purchases per Power Test distributors for the period June 1980 through February 1982 amounted to \$2,155,293.00. Taxable sales reported by petitioners for the same period were \$111,391.00. The audit report assumes that even if sales were made at cost, additional sales would result in the amount of \$2,043,902.00. Taxable gas purchases were marked up an estimated 10% resulting in total audited taxable sales for the period June 1980 through February 1982 of \$2,370,822.00. Applying the margin of error to the reported taxable sales for the audit period resulted in additional taxable sales of \$2,646,286.00 and additional sales tax due of \$189,727.18. On February 24, 1984, two notices of determination and demands for payment of sales and use taxes due were issued to Arper Discount Center, Ltd. and Kanat Arbay, as officer, in the amount of \$189,727.18, with an assertion of a 50% fraud penalty and maximum interest for a total assessment of \$343,836.50. The periods listed on the notices of determination

²The Nassau District Office is also referred to as the Mineola District Office by the parties.

showed tax, fraud penalty and interest due as follows:

<u>"Period Ended</u>	<u>Tax Due</u>	<u>Fraud Penalty</u>	<u>Interest</u>
08/31/80 - 181	7,113.54	3,556.77	3,286.52
11/30/80 - 281	7,433.02	3,716.51	3,198.42
02/28/81 - 381	20,004.46	10,002.23	7,980.57
05/31/81 - 481	23,233.28	11,616.64	8,523.82
08/31/81 - 182	31,242.75	15,621.37	10,390.08
11/30/81 - 282	44,470.20	22,235.10	13,144.05
02/28/82 - 382	27,132.12	13,566.06	7,034.27
05/31/82 - 482	6,729.38	3,364.69	1,501.99
08/31/82 - 183	22,368.43	11,184.21	4,186.02"

In addition to the tax asserted, the notice of determination issued to Mr. Arbay as officer stated the following:

"You are personally liable as officer of Arper Discount Center Ltd. under Sections 1131(1) and 1133 of the Tax Law for the following taxes determined to be due in accordance with Section 1138(a) of the Tax Law."

On March 27, 1985, an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due was issued to both Arper Discount Center, Ltd. and Kanat Arbay assessing sales tax due for the quarter ended May 31, 1980 in the amount of \$9,227.08, in addition to a fraud penalty of 50% plus statutory interest, yielding a total assessment of \$20,315.92. There appears to be no discussion on the record as to why this notice was issued at a later date, and whether the basis for this notice is the same as the assessment for \$189,727.18.

Jack Portney, Certified Public Accountant, appeared on behalf of petitioners to represent their positions. Mr. Portney testified that Kanat Arbay obtained gasoline not only for his own retail sale purposes but also for resale. He made reference to the fact that Mr. Arbay would pump gasoline from the station during the night when his business was not in operation with a special pump purchased for that purpose. Evidence submitted by Mr. Portney on behalf of petitioners' resale contention included sales invoices covering the period June 1980 through March 1982, showing sales of various types of gasoline to Sevinc and Ahmet Batur at 2 Saratoga Boulevard, Island Park, New York and Apokan Discount, 189 Sunrise Highway, Amityville, New York, totalling over \$2,300,000.00. He also submitted the original resale certificate executed by Ahmet Batur to Arper Discount Center Ltd. dated May 15, 1980

indicating that there were services for resale.³ Mr. Portney also presented a schedule of purchases of gasoline between June 1980 and March 1982 offset by sales for resale in gallons and dollars as well as retail sales to customers. Lastly, he submitted correspondence which was a verification from the Henrich Petroleum Equipment Co., Inc. dated July 10, 1985 stating that Kanat Arbay purchased a Blackmer explosion-proof pump from this corporation during the year 1978 and that since they were unable to locate the invoice this letter was being submitted as part of the proof of purchase.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner does not dispute the gasoline purchases verified by Power Test, but submits evidence and contends that a substantial portion of the gasoline so purchased was for resale, and that the Division of Taxation's rejection of such evidence is without foundation.

The Division of Taxation relies on the supplier verification and asserts additional taxable sales. The Division contends that books and records were poorly kept in this case, and it was proper to use external indices to determine the proper tax. In this case, such indices were the use of third-party gasoline figures from the Power Test corporation. Although there is testimony indicating that Mr. Batur owned a number of gas stations, the Division asserts that the Power Test gasoline was unlikely to have been sold by Kanat Arbay to Mr. Batur since he was operating an Award Station. The Division indicated that Mr. Batur could not be reached to verify the resale transaction, and as a result there was actually very little documentation submitted to prove the resale portion of the transaction.

CONCLUSIONS OF LAW

A. Section 1138(a) of the Tax Law provides, in pertinent part, that a notice of determination of tax due shall be given to the person liable for the collection or payment of the

³There is testimony in the record reflecting the fact that box A on the resale certificate referring to the resale of tangible personal property may have been a more appropriate indication of the transactions as they existed in this case, in contrast to box C which was checked, indicating that there were services resold. Regardless of the accuracy of the resale certificate, the parties agree that the item in issue is the resale of gasoline only.

tax, and that such determination shall finally and irrevocably fix the tax unless the person against whom it is assessed shall within 90 days after giving notice of such determination, apply to the Division of Tax Appeals for a hearing or unless the Commissioner of Taxation and Finance of his own motion shall redetermine the same. Notices numbered S831220051F and S831220050F apparently were never petitioned. Thus, this forum technically has no jurisdiction to address those notices. However, it is clear from the record that both of those notices as well as notices S840920015F and S840920016F were prematurely issued and never intended to reflect additional tax due for the period being audited. The testimony indicated that audit procedures had barely begun and that further investigation was being done for the purpose of determining an assessment. The position of the Division of Taxation relies upon the calculation of gasoline purchases per the Power Test information. The notices stated above were derived from purchases per books. Any testimony pertaining to calculations and review of records was directly in connection with the Mineola District Office report, and not the prior Suffolk County report. It clearly appears as though the notices issued December 20, 1983 and September 20, 1984 should be cancelled.

B. The Tax Law imposes a sales tax on the retail sale of tangible personal property (Tax Law § 1105[a]). A "retail sale" is generally defined as a sale of tangible personal property for any purpose other than for resale or for use in a taxable service where the property purchased becomes a physical component of the property serviced or is actually transferred to the purchaser of the service (see, Tax Law § 1101[b][4]). A vendor is obligated to maintain records of his sales for audit purposes (Tax Law § 1135) and the Division, when conducting an audit must determine the amount of tax due "from such information as may be available. If necessary, the tax may be estimated on the basis of external indices" (Tax Law § 1138[a][1]). When conducting an audit, the Division of Taxation may not simply ignore taxpayers' records if those records provide an adequate basis on which to determine the amount of tax due (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44). To determine the adequacy of the taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and

records for the entire period of the proposed assessment (Matter of King Crab v. State Tax Commn., 134 AD2d 51). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair v. State Tax Commn., supra). Considerable latitude is given to the auditor where the taxpayer's records are inadequate. It is only necessary that the Division select an audit method reasonably calculated to reflect the tax due and then it is incumbent upon the petitioner to establish that the result of the method used is unreasonably inaccurate or that the amount of tax assessed is erroneous (Matter of Meskouris Brothers v. Chu, 139 AD2d 813).

In this case, it appears that an adequate request for records was made by the Suffolk District Office. However, it does not appear as though Suffolk had a sufficient opportunity to completely review or audit petitioners' records. The Special Investigations Bureau then received the file, and was instructed to review and investigate the operations of this gasoline station as well as many others. Before such investigations were complete in their entirety, files were closed and transferred to various other offices, in this case, the Nassau District Office. No evidence was presented by the Division of Taxation to support the fact that the records were deemed insufficient to the extent that it was impossible to verify taxable sales or conduct a complete audit. Mr. Coughlin testified that he requested gasoline supplier information because there was a large discrepancy between purchases per books and sales reported on the sales tax returns for the same period. If we assume that it was impossible to determine the corporation's tax liability solely from its records, resort to outside indices, such as the purchases from Power Test was proper (Matter of Urban Liquors, Inc. v. State Tax Commn., 90 AD2d 576; Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988).

It was the auditor's duty to select a method of audit reasonably calculated to reflect the taxes due (Matter of Grant Co. v. Joseph, 2 NY2d 196). In view of the enormous discrepancy between petitioners' reported sales and purchases per books and supplier information, the Division was warranted in questioning the adequacy of petitioners' records and giving serious

consideration to an estimate based on third-party verification. Even if one argues that the most accurate way to verify taxable sales in this case was by third-party verification, the next crucial step in the transaction was simply ignored by the Division of Taxation, i.e. the resale. The burden was then placed upon petitioners to show by clear and convincing evidence that the audit methodology was unreasonable or that the results obtained were erroneous (Surface Line Operators Fraternal Organization v. Tully, 85 AD2d 858).

C. As discussed above, the definition of retail sale expressly excludes purchases of tangible personal property for resale as such. A vendor who receives a properly completed resale certificate is not liable for failure to collect sales tax even if the purchaser erroneously gave such certificate unless the vendor has knowledge of the falsehood. Even if a resale certificate is not produced, the vendor may claim the sale is not subject to tax if he is able to show the sale qualifies for the resale exclusion (Matter of Ruemil Contract Interiors, Inc., State Tax Commn., September 9, 1983).

D. Petitioners in this case allege that they were able to obtain large allocations of gasoline and did so primarily for the purpose of resale to other gasoline station vendors. Petitioners produced sales invoices for substantially all of the months of the period in question. These invoices were supported by a resale certificate completed by one of the two parties to whom the sales were made. Petitioners further supported their case with information regarding an explosion-proof pump purchased for the purpose of pumping gasoline from the delivery site to another tank or truck.

E. Petitioners have met their burden of proving that the results of the investigation and that portion of the audit so performed resulted in erroneous assessments. The Division of Taxation's objections to the resale certificates and the sales invoices are not only weak, but lack merit. It is clear in this case that the Division grossly and deliberately overlooked the records supporting the resale of gasoline by petitioners.

F. Bearing in mind that this administrative body does not have jurisdiction over the notices of determination dated December 20, 1983, issued to both Arper Discount Center, Ltd.

and Kanat Arbay, as officer, it appears as though both the December 20, 1983 notices and the September 20, 1984 notices were issued prematurely, in error and are essentially a duplication of quarters that were assessed once a complete investigation had taken place. It appears as though the intention of the Division of Taxation was to issue the notices of February 24, 1984 and March 27, 1985 as complete assessments of sales and use taxes due, since it is improper to assess taxpayers by duplicate assessments. Thus, the notices dated December 20, 1983 and September 20, 1984 should be cancelled.

G. Since it has been determined that there is no liability due, the issues of whether Kanat Arbay was a person required to collect tax and whether the fraud penalty should stand, need not be addressed.

H. The petitions of Arper Discount Center, Ltd. and Kanat Arbay are granted, and the notices of determination and demands for payment of sales and use taxes due dated February 24, 1984 and March 27, 1985 are hereby cancelled.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE